VZCZCXRO1859
OO RUEHCHI RUEHCN RUEHDT RUEHFK RUEHHM RUEHKSO RUEHNAG RUEHPB
DE RUEHML #0680/01 0860815
ZNR UUUUU ZZH
O 270815Z MAR 09
FM AMEMBASSY MANILA
TO RUEHC/SECSTATE WASHDC IMMEDIATE 3663
RUEATRS/DEPT OF TREASURY WASHDC IMMEDIATE
INFO RUEHZS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS IMMEDIATE
RUEHZU/ASIAN PACIFIC ECONOMIC COOPERATION
RHHMUNA/USPACOM HONOLULU HI//FPA//

UNCLAS SECTION 01 OF 03 MANILA 000680

SENSITIVE

SIPDIS

STATE FOR EAP/MTS, EAP/EP/ EEB/IFD/OMA
STATE PASS EXIM, OPIC, AND USTR
STATE PASS USAID FOR AA/ANE, AA/EGAT, DAA/ANE
TREASURY FOR OASIA

E.O. 12958: N/A
TAGS: EFIN ECON ECIN RP CN XE XD
SUBJECT: Economic Crisis/Fiscal Crunch in the Philippines

REF: Manila 0378

SENSITIVE BUT UNCLASSIFIED

¶1. (SBU) Summary: The Government abandoned its 2008 balanced-budget goal and plans a higher deficit of 2.2% of Gross Domestic Product for 2009 -- a modest stimulus relative to the deficit spending being pursued by regional neighbors in response to the global financial crisis. We assess that the GRP policy response has been appropriate given the circumstances, but remain concerned about tax collections and, ultimately, fiscal sustainability. End Summary.

Philippines Abandons Balanced Budget Goal...

¶2. (U) Faced with food and oil price shocks, the global financial crisis, and slowing economic growth, the Philippine Government abandoned its plan for a balanced budget in 2008 and revised its fiscal program to a 75 billion peso (exchange rate is about 48 pesos to the dollar) deficit, equivalent to 1% of Gross Domestic Product (GDP). The revised program, which marked a reversal from declining deficit-to-GDP ratios (from a peak 5.6% in 2003 to 0.2% by 2007) reflected a 15.5 billion peso downward adjustment in the original tax collection target; a 4.4 billion peso upward adjustment in the non-tax revenue goal; and 64 billion pesos in additional expenditures, partly to accommodate higher rice imports and social spending.

Selected Fiscal Indicators
(As % of GDP)

	2001	2002	2003	2004	2005	2006	2007	2008
Revenues	15.5	14.6	14.8	14.5	15.0	16.2	17.1	16.0
Tax	13.6	12.8	12.8	12.4	13.0	14.3	14.0	14.0
Non-Tax	2.0	1.8	2.1	2.1	2.0	2.0	3.1	2.1
Expend.	19.7	19.9	19.5	18.3	17.7	17.3	17.3	17.0
Debt Serv.	4.8	4.7	5.2	5.4	5.5	5.1	4.0	3.6
Non-Debt	14.9	15.2	14.3	12.9	12.2	12.2	13.3	13.4
Deficit	-4.0	-5.3	-4.6	-3.8	-2.7	-1.1	-0.2	-0.9
Outstanding Debt	65.7	72.5	77.7	78.2	71.5	63.8	55.8	56.3

Source: Philippine Dept. of Budget and Management

¶3. (U) The Government reduced its revenue goal partly because the Philippine Congress passed a tax relief measure for minimum wage earners and individual taxpayers and President Arroyo issued an Executive Order reducing or scrapping tariffs on imported crude oil and refined petroleum when international prices hit certain "triggers." These tax relief measures cost the Government an estimated 28.5 billion pesos in potential revenues in 2008, equivalent to more than 0.3% of GDP.

¶4. (U) The Government reported recently that it closed 2008 with a fiscal deficit of 68.1 billion pesos, 0.9% of GDP. Underlying that performance was a 44 billion peso slippage in tax collections vis-`-vis an already reduced goal. About 22 billion pesos in higher-than-targeted non-tax revenues and 29 billion pesos in lower-than-programmed spending (reflecting project implementation and absorptive capacity constraints) more than offset lower-than-targeted tax collections.

...Programs Larger Deficit in 2009

¶5. (U) President Arroyo signed the 2009 budget into law on March 13, 2009. The fiscal plan allows for a higher deficit (177.2 billion pesos) equivalent to 2.2% of GDP. It accommodates a 17.1% nominal expansion in non-debt expenditures (equivalent to about 13.5% growth after inflation) to allow larger capital outlays and pro-poor spending. As a ratio to GDP, the Government projects a rise in non-debt spending from 13.4% of GDP in 2008 to 14.5% in ¶2009.

¶6. (U) This year's budget increases infrastructure outlays by more

than 35% to 2.1% of GDP in 2009. The Government hopes to frontload 60% of infrastructure spending and other vital social services during the first half of the year to help spur economic growth. Philippine Budget Department officials noted that the focus will be smaller, quick-disbursing infrastructure projects with allotments lapsing monthly ("use or lose") to spur agencies to closely monitor project/program implementation.

2009 Budget, Selected Agencies

	Levels (Billion Pesos) 2008	2009	Growth Rate (%) 2008-2009	Average 1998-2008
Economic/Infrastructure				
Dept of Public Works	102.4	137.5	34.3	10.1
Dept of Transport/ Communications	22.8	26.1	14.7	10.5
Dept. of Agriculture	25.4	42.6	67.3	3.6
Social Services				
Dept. of Education	149.3	171.5	15.0	6.2
Dept. of Health	20.3	28.5	40.4	6.2
Dept. of Social Welfare	4.9	10.7	118.2	10.6

Source: Philippine Dept. of Budget and Management

¶7. (SBU) Respected economists here have noted that the 2009 budget would be more accurately described as a "measured fiscal expansion" rather than "stimulus" vis-`-vis the significantly more aggressive deficit-to-GDP ratios programmed elsewhere in the region (averaging about 4.5% in ASEAN) in response to the global financial turmoil. Although it has come down, the Government's debt-to-GDP ratio (more than 56% in 2008) remains high relative to those of regional and emerging economies and constrains more aggressive deficit spending. Policymakers remain wary of rekindling concerns about the GRP's

commitment to fiscal discipline and of potentially spooking credit markets.

Challenges

¶8. (SBU) The government is hoping for a 10% (104 billion peso) year-on-year expansion in tax collections during 2009 to finance the budget and contain the fiscal deficit within 2.2% of GDP. However, the budget's assumption of economic growth of 3.7% is now regarded as very optimistic. The target is even more ambitious than it seems given expected erosion to collections of some 45 billion pesos, or 0.5% of GDP, resulting from previously scheduled tax reductions and tax breaks passed in 2008. Revenues face further pressures after 2011, when there will be no further biennial increases in excise taxes on liquor and cigarettes. While the Department of Finance has a long wish list of revenue-enhancing legislation sitting in Congress -- principally rationalizing fiscal incentives, reforming the excise tax system for cigarettes and liquor, and controlling excessive business deductions through the introduction of a simplified net income taxations system for professionals and the self-employed -- it is unclear whether that agenda can garner even united executive branch support in the run-up to national elections.

Weak Tax Administration and Corruption

¶9. (SBU) The Arroyo Administration deserves credit for averting a fiscal crisis through tax measures implemented several years ago, which has allowed it to implement modest expansionary policy during the current economic downturn. That said, policymakers are making the best of the current situation via limited and responsible expansion while providing themselves with political cover by "talking big" about their "stimulus package."

¶10. (U) However, weak tax administration continues to undermine revenue potential and remains a serious challenge. Tax effort declined consecutively from 1997's 17.0% peak to 12.4% in 2004. Tax increases in 2005 and 2006 brought tax effort back up to 14%, but despite frequently and loudly proclaimed efforts to increase

compliance the numbers have been stagnant since then. A recent paper by a respected economic think tank concluded that improvements in collections were due largely to changes in tax policy, which are counterbalanced by tax leakages averaging some 0.5 percentage points annually.

¶11. (SBU) Corruption is also a serious problem for tax collection. A respected polling organization found in a 2008 survey of enterprises that 46% were asked by government officials for a bribe in relation to the assessment and payment of income taxes. Nearly a third reported having been asked for a bribe in relation to compliance with import regulations and the payment of import duties.

Comment

¶12. (SBU) The impact of the global economic downturn, though significant, has not been severe in the Philippines, as yet (reftel). Given the constraints under which GRP fiscal policy operates, we believe policy to date has been appropriate. While markets for GRP debt have so far been accepting of further debt financing, they might be less so were the fiscal situation to begin to unravel. While we do not expect that to happen this year, the risk is not insignificant.

Kenney